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ABSTRACT

Intended to provide insight into the dynamics of demand analysis, this paper presents an eight-step method for forecasting sales. Focusing on sales levels that must be achieved to enjoy targeted profits in favor of the usual approach of emphasizing how much will be sold within a given period, a sample situation is provided to illustrate this approach. In this situation, the eight-step method helps a married individual with a working spouse, dependent children, and a $25,000 per year job determine how many sales dollars a new retail operation must provide during its first year to make quitting his/her present job a reasonable risk. A format for computing a projected statement of net income (or loss) is provided to help determine survival sales levels the first year. Next, the eight-step solution to survival sales suggests that forecasters (1) survey the competition, (2) research potential suppliers, (3) compute the gross profit, (4) estimate the firm's annual operating (or ongoing) expenses, (5) compute the estimated gross profit, (6) forecast the survival sales level, (7) derive the cost of goods sold, and (8) complete a formula (provided) in which operating expenses and net income (expressed in percentage of sales) are figured by dividing operating expenses (in dollars) by sales dollars and then subtracting that percentage figure from gross profit percentage. Three tables are provided for computation. (LH)

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SURVIVAL SALES FORECASTING

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Theorists and practitioners of entrepreneurship, or how to start a business, cower from the task of forecasting sales for a new venture - one, two, three years out. Textbook discussions of "macro" and "micro" approaches for estimating demand are often abstruse or vague, lacking a detailed "how to" recipe that aspiring entrepreneurs can appreciate and will use.

The Survival Sales Forecasting Method presented here does not tell an entrepreneur how much of a particular product or service <u>will</u> be sold within a given time period, but rather how much <u>must</u> be sold, that is, what sales level <u>must</u> be achieved to enjoy targeted profits and, perhaps, to maintain a desired lifestyle.

The following example illustrates the mechanics of the Survival Method for forecasting sales. Many assumptions have been made. The reader must adapt this method to his or her own plans and aspirations. Hopefully, the example will provide some insight into the confusing issue of demand analysis before substantial chunks of time, emotion, and capital are invested in a disappointing new venture.

Let's assume the following situation. You're married with dependent children and a working spouse whose annual salary is $ 25000. You believe that you have the drive and intelligence to start and manage a new business successfully. You're tempted to quit your $ 25000 job to set up a cash and carry retail store, specializing in a single product category. You want to enjoy the independence of a sole proprietor.

Unhappily, you're unable to borrow considerable capital and don't have a wealthy relative who will stake you. Your savings will only cover start-up costs (e.g., initial inventory or fixtures) and a minimal reserve for emergencies. Also, you're convinced that you need $ 50000 annually before taxes to maintain a subsistence lifestyle, which your salary and your spouse's have provided to date.

$ 50000 Question: How many sales dollars must your new retail operation provide - first year - to pull your $ 25000 share of your family's financial burden? (Note that your firm would start its second year without capital in reserve if you spent the entire $ 25000.)

Figure #1 is an incomplete projected statement of net income (or loss) for your firm's first year, expressed in dollars and percentages. It shows that Sales minus cost of goods sold equal gross profit minus operating expenses equals net income (or loss). At this point, you are able to complete only two blanks: (1) Sales, expressed as a percentage, and (5') expected income, expressed in dollars.

Figure #1

			%		$
	Sales	(1)	100	(1')	
-	Cost of Goods Sold	(2)		(2')	
=	Gross Profit	(3)		(3')	
-	Operating Expenses	(4)		(4')	
=	Net Income (loss) Before Taxes	(5)		(5')	25000

How can you use these two pieces of information, (1) and (5'), to compute your survival sales level for the first year?

8 Step Solution

Step #1: SURVEY YOUR COMPETITION to find out the price range at which your product is being sold. Unless you can provide a bundle of related services that exceeds your competition's, you should not expect to charge more than your competition for your product. (In fact, to be brutally conservative, you might assume that you would not charge more than your competitors' lowest price.) Assuming the lowest competing price is $ 4.00 per unit, your selling price would be $ 4.00.

Step #2: RESEARCH POTENTIAL SUPPLIERS for your product to determine your cost of goods sold per unit. (Again, to be ultra-conservative, you might assume that you'll order minimum quantities, thereby paying top dollar for your product.) Let's say that your cost per unit of product sold would be $ 3.00.

Step #3: COMPUTE YOUR GROSS PROFIT (expressed as a percentage of sales) by subtracting your product's unit cost from its unit price ($ 4.00 - $ 3.00 = $ 1.00) and dividing the difference by the unit price ($1.00/$4.00 = 25%).

Step #4: ESTIMATE YOUR FIRM'S ANNUAL OPERATING (OR ONGOING) EXPENSES. Unhappily, there is no short cut for developing these figures. Rent, for example, may be estimated by contacting a realtor or tenant of a store about the size and in about the location you want yours to be. Let's assume that your estimate of annual rent, utilities, part-time help, advertising, and interest on a small loan is $ 11,800. (Note that as a sole proprietor you can not deduct money you withdraw from the business for personal use as a business expense. Also, it may be wise to overestimate these expenses to allow for error or unexpected increases.)

Figure #2 further develops your projected Income Statement, based on the results of Steps #1 through 4:

Figure #2

			%		$
	Sales	(1)	100	(1')	
-	Cost of Goods Sold	(2)		(2')	
=	Gross Profit	(3)	25	(3')	
-	Operating Expenses	(4)		(4')	11800
=	Net Income (loss) Before Taxes	(5)		(5')	25000

Step #5: COMPUTE YOUR ESTIMATED GROSS PROFIT (in dollars) by adding estimated annual operating expenses and desired net income before income taxes ($ 11800 + $ 25000 = $ 36800).

Step #6: FORECAST YOUR SURVIVAL SALES LEVEL (in dollars) by dividing estimated annual gross profits (in dollars) by gross profit (expressed as a percentage of sales): $ 36000/0.25 = $ 147200.

Step #7: DERIVE YOUR COST OF GOODS SOLD (in dollars and as a percentage of sales) by subtracting gross profit from sales: $ 147200 - $ 36800 = $ 110400, that is, 100% - 25% = 75%.

Step #8: COMPLETE Figure #3, deriving operating expenses and net income (both expressed as a percentage of sales) by dividing operating expenses (in dollars) by sales dollars and then subtracting that percentage figure from your gross profit percentage:

Figure #3

		%		$
	Sales	(1) 100	(1')	147200
-	Cost of Goods Sold	(2) 75	(2')	110400
=	Gross Profit	(3) 25	(3')	36800
-	Operating Expenses	(4) 8	(4')	11800
=	Net Income (loss) Before Taxes	(5) 17	(5')	25000

The above example makes many assumptions. Some may not match your marital status, desired form of legal ownership, type of business or subsistence lifestyle. Nor does it account for your self-employed, state, or federal income tax obligations. You'll have to change particulars to match your current and desired goals. In an case, it's better to know how much you must sell, in any type of new business, in order to meet your targeted objectives, if you plan to beat the odds of business failure - currently set at about 9 to 1 against you!

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